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Department of the Treasury  
Washington, DC 20224

[Third Party Communication:  
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Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_

Telephone Number:

Refer Reply To:  
TEGE:EO2  
PLR-142140-07  
Date:  
November 09, 2007

### Legend

Corporation =

State =

Act =

Commission =

City =

City Council =

Trust =

Statute =

Dear \_\_\_\_\_ :

This is in reply to a letter dated September 14, 2007, requesting a ruling that the income of Corporation is excluded from gross income under section 115(1) of the Internal Revenue Code.

## FACTS

Corporation is a non-profit corporation created pursuant to State Act. Corporation was formed for the purpose of financing the restoration of State's utility infrastructure from damage caused by natural disasters. As provided by Act, Corporation is governed by a board of seven directors. Two directors are selected by and serve at the pleasure of the governor of State. Five directors are State or City officials or their designees.

Corporation is subject to regulation by Commission, which is a part of the executive branch of State. Pursuant to Act, a utility may petition Commission for a financing order. In the case of utilities subject to regulation by City rather than by Commission, the utility will petition the City Council rather than Commission for a financing order. The financing order, if granted by Commission, allows Corporation to impose charges on the customer of the utility requesting the financing order in an amount approved by Commission. Trust, a public trust created by State Statute and for which State is the beneficiary, will issue taxable bonds on Corporation's behalf. Trust loans the bond proceeds to Corporation. In exchange for the bond proceeds, Corporation transfers its right to impose charges on the customers of the utility to which the financing order relates to Trust as security for the loan. Upon deposit of the bond proceeds into Corporation's fund the utility is entitled to request disbursements from Corporation in an amount approved by Commission. This disbursement is characterized by Act as a non-shareholder contribution of capital to the utility. Charges assessed by Corporation and collected by the utility from its customers pursuant to the financing order are turned over to Corporation. Corporation distributes the charges to Trust to the extent needed to pay off the bonds issued pursuant to the financing order. Corporation cannot dissolve until the bond holders have been paid off.

Funds received by Corporation include bond proceeds from Trust and customer charges collected by the utilities. Funds dispersed by Corporation include capital contributions made to the utilities and bond premium payments made to Trust. Under no circumstances will any of the net earnings or assets of Corporation inure or be distributed to the benefit of any private person, except that Corporation may pay reasonable compensation for services rendered and make payments and distributions in furtherance of the purposes of Act.

In the event of the dissolution of Corporation, its assets will be applied first to pay all debts, liabilities and obligations of Corporation, including the establishment of reasonable reserves for any contingent liabilities or obligations, and all remaining funds of Corporation will be applied and distributed as provided by an order of Commission. Corporation proposes to amend Corporation's articles of incorporation to provide that in no case will Corporation's assets be distributed to an entity that is not a state, a political

subdivision of a state or an entity the income of which is excluded from gross income under section 115 of the Internal Revenue Code.

### LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Corporation provides low cost capital to utilities impacted by natural disasters while minimizing the rates utilities must charge to their customers. Corporation contributes to the speedy restoration of severely damaged utility infrastructure, thereby promoting the economic recovery and economic development of State. By promoting economic development, Corporation performs an essential government function within the meaning of § 115(1) of the Code.

The income of Corporation accrues to State. No private interests participate in the operation of Corporation. The benefit to private parties is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted by Corporation, we hold that the income of Corporation is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Corporation's income is excludable from gross income under § 115(1) of the Code.

No opinion is expressed concerning the federal tax consequences under any other provision of the Code other than those cited above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

Sincerely,

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Sylvia Hunt  
Assistant Branch Chief, Exempt Organizations  
Branch 2  
Division Counsel/Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures:

Copy of this letter

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